UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 00-9030

NANCY J. HUKKANEN-CAMPBELL,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeal from the Decision of the
United States Tax Court
(T.C. Docket No. 12371-98)

[Filed December 19, 2001]

Before KELLY and McKAY, Circuit Judges, and BROWN, Senior District Judge.*

McKAY, Circuit Judge.

Petitioner prevailed in a Title VII lawsuit against her former employer. The defendant in that action paid Petitioner $150,000 in partial satisfaction of the judgment. The $150,000 payment was issued jointly to Petitioner and her attorneys. She received $76,600.75 of the settlement; her attorneys retained the remaining $73,399.25 as legal fees.

* Honorable Wesley E. Brown, Senior United States District Judge for the District of Kansas, sitting by designation.

Originally, Petitioner reported the entire $150,000 as "Other Income" on her 1993 federal income tax return. She also claimed an itemized deduction for the legal fees. In 1995, she filed an amended tax return in which she excluded the $150,000 payment from her income entirely, claiming a refund of $20,075. The Commissioner denied the refund and issued to her a deficiency notice in the amount of $17,402. This deficiency resulted from the application of the Alternative Minimum Tax ("AMT"). The AMT precludes various miscellaneous itemized deductions including fees paid to attorneys by taxpayers.

Petitioner challenged the deficiency in Tax Court arguing that the proceeds of the lawsuit were excluded from income under § 104(a)(2). Alternatively, she argued that the portion paid to her attorneys pursuant to her contingent fee arrangement was not includable in gross income. The Tax Court held that the entire $150,000 was subject to taxation and that the amount paid to her attorneys qualified as a miscellaneous itemized deduction. However, since the computation of the AMT disallows deductions for attorney fees, the Tax Court upheld the $17,402 deficiency. Petitioner timely appealed. We have jurisdiction under 26 U.S.C. § 7482(a)(1).

The current dispute has increased meaning because of the AMT's treatment of attorney fees. If the AMT did not apply, any fees Petitioner paid to her attorneys would qualify as a deductible expense. However, under the AMT's provisions, certain miscellaneous deductions, including attorney fees, are eliminated.

Petitioner argues that the Internal Revenue Code does not require that the payment made to her attorneys be included in her income. Section 61(a) of the Code defines gross income as "all income from whatever source derived." 26 U.S.C. § 61(a). The $150,000 she recovered in her Title VII suit clearly constitutes income from "whatever source derived."

We reject Petitioner's argument that she lacked the requisite control and beneficial ownership of the funds paid directly to her attorney. Regardless of the label placed on the contract between Petitioner and her attorneys, the end result is that the recovery of legal fees benefitted her. This recovery permitted Petitioner to discharge the personal obligation owed to her attorneys. *See Coady v. Commissioner*, 213 F.3d 1187, 1191 (9th Cir. 2000); *Baylin v. United States*, 43 F.3d 1451, 1454 (Fed. Cir. 1995).

Petitioner's argument that the effect of her contingent fee agreement and the Missouri lien statute alters the analysis is equally unavailing. Petitioner points to rulings in other circuits holding that contingent fees paid directly to attorneys are not taxable income based on the applicable attorney lien statutes. *See, e.g., Foster v. United States*, 249 F.3d 1275 (11th Cir. 2001) (Alabama statute); *Estate of Clarks v. United States*, 202 F.3d 854 (6th Cir. 2000) (Michigan statute); *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959) (Alabama statute). However, the majority of the circuits have rejected this argument. *See, e.g., Kenseth v. Commissioner*, 259 F.3d 881 (7th Cir. 2001) (Wisconsin statute); *Young v. Commissioner*, 240 F.3d 369 (4th Cir. 2001) (North Carolina statute); *Benci-Woodward v. Commissioner*, 219 F.3d 941 (9th Cir. 2000) (California statute); *Coady v. Commissioner*, 213 F.3d 1187 (9th Cir. 2000) (Alaska statute); *Baylin v. Maryland*, 43 F.3d 1451 (Fed. Cir. 1995) (Maryland statute).

Furthermore, the cases Petitioner relies upon are readily distinguished. As the Tax Court correctly noted, the Missouri lien statute, unlike the Alabama and Michigan statutes, does not create a proprietary interest in the recovery on the attorney's behalf. Instead, the Missouri statute simply operates as a manner of ensuring payment to the attorney. As the Seventh Circuit recently observed, an attorney with a lien on settlement "is no different in this respect from any other trade creditor stiffed by his debtor." *Kenseth*, 259 F.3d at 884.

Petitioner urges us to adopt a uniform standard that contingent fee payments made directly to attorneys for their services should not be taxable to successful plaintiffs. She advocates a standard independent of "the intricacies of an attorney's bundle of rights against the opposing party under the law of the governing state." Aplt. Brief at 25 (quoting *Srivastava v. Commissioner*, 220 F.3d 353, 364 (5th Cir. 2000). Her reliance on *Srivastava* is misplaced. In *Srivastava*, the Fifth Circuit specifically stated, "[W]ere we to decide this case as an original matter, we might apply the anticipatory assignment doctrine to hold that contingent fees are gross income to the client. We do not, however, decide this case on a clean slate, but must follow the contrary approach endorsed in *Cotnam*." *Srivastava*, 220 F.3d at 363. Not only has the Fifth Circuit's ruling in *Srivastava* been widely criticized, *see, e.g.*, Benjamin C. Rasmussen, Note, *Taxation of an Attorney's Contingency Fee of a Punitive Damages Recovery: The Srivastava Approach*, 15 BYU J. Pub. L. 301 (2001), but we, unlike the Fifth Circuit, decide this case on a clean slate.

We agree with Petitioner that a universal standard independent of the "intricacies of any attorney's bundle of rights," or the unique provisions of a particular state's attorney lien statute is desirable. However, her proposed solution is inconsistent with the Tax Code. The correct approach is much more simple. Petitioner's judgment is a recovery of lost income; the attorney fees she paid represent expenses incurred in generating that income. Like any other taxpayer, Petitioner must report the entire amount as gross income, and, but for the AMT's provisions, she would be allowed to deduct her attorney fees as an expense. The Tax Code mandates this result irrespective of a particular state's attorney lien statute's provisions.

Finally, Petitioner invites us to judicially overturn what she terms an "anomalous and unjust result" created by the application of the AMT to the present case. We must reject this invitation. The perceived inequities of the AMT are simply

not at issue here. Congress, not this court, must correct any shortcomings in the AMT's application.

The Tax Court's decision is **AFFIRMED**.

UNITED STATES TAX COURT

Docket No. 12371-98

NANCY J. HUKKANEN-CAMPBELL,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Filed June 12, 2000.

MEMORANDUM FINDINGS OF FACT AND OPINION

GERBER, *Judge*: In a notice of deficiency addressed to petitioner, respondent determined a deficiency of $17,402 in petitioner's Federal income tax for the year ended December 31, 1993. The issues for our consideration are: (1) Whether petitioner's $150,000 judgment received in an action under the pre-1991 title VII of the Civil Rights Act of 1964, Pub. L. 88-352, 78 Stat. 241 (title VII), is excludable from gross income under section 104(a)(2); and (2) if the title VII proceeds are includable in income, whether petitioner is entitled to exclude from gross income that portion of the proceeds paid as attorney's fees under her contingent fee retainer agreement.

FINDINGS OF FACT[1]

The facts in this case have been fully stipulated, and the case was submitted to the Court under Rule 122.[2] Petitioner resided in Shawnee, Kansas, at the time her petition was filed in this case.

Petitioner was employed at the International Union of Operating Engineers, Hoisting and Portable Local No. 101 (Local 101) from July 10, 1978, to October 29, 1984. On May 23, 1990, petitioner filed a Complaint in the U.S. District Court for the Western District of Missouri, Western Division, against Local 101 and against Sam F. Long (Long), the Chief Executive Officer of Local 101 during petitioner's employment. Petitioner's Complaint contained the allegation that, in 1984, she was constructively discharged in violation of title VII. Petitioner sought injunctive relief, backpay, front pay (the monetary equivalent of reinstatement), benefits, attorney's fees, and reasonable costs.

The District Court ruled in favor of petitioner and found that petitioner had been subjected to unwelcome sexual harassment based on petitioner's gender and that such harassment was sufficiently severe and pervasive so as to unreasonably interfere with her work performance and create an intimidating, hostile, and offensive work environment. The District Court entered a Final Judgment on April 3, 1992, awarding petitioner $52,492 in backpay, $44,418.06 in front pay, $82,534.81 in pension benefits, $85,227.50 in attorney's fees, and $1,016.90 in reasonable costs. Local 301 and Long appealed, and petitioner cross-appealed, to the U.S. Court of Appeals for the Eighth Circuit. The Court of Appeals upheld the backpay, front pay,

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[1] The stipulation of facts and the attached exhibits are incorporated herein by this reference.

[2] Unless otherwise indicated, Rule references are to this Court's Rules of Practice and Procedure, and section references are to the Internal Revenue Code in effect for the taxable year in question.

and pension benefits, and remanded the attorney's fees award to the District Court for further consideration. See *Hukkanen v. International Union of Operating Engrs., Hoisting & Portable Local No. 101*, 3 F.3d 281 (8th Cir. 1993).

In connection with petitioner's lawsuit, petitioner and her attorneys entered into a Contract for Employment for Litigation on a Contingency Fee Basis (contingency fee contract). The contingency fee contract provided that petitioner's attorneys would receive 45 percent of the total recovery, including attorney's fees, or $125 per hour for all time from the beginning of the case to completion, or the court-awarded fee, whichever figure was greater, plus any expenses that were not paid by petitioner. In no event, however, was petitioner to receive less than 25 percent of the combined award of attorney's fees and client award after deduction of expenses.

On December 21, 1993, Local 101 paid petitioner $150,000 in partial satisfaction of the title VII judgment. The payment was made jointly to petitioner and her attorneys. Ultimately, $76,600.75 was retained by petitioner, and $73,399.25, as legal fees, was retained by petitioner's attorneys.

Petitioner timely filed her Federal income tax return for the 1993 taxable year (1993 original return) and reported the entire $150,000 judgment as "Other income" and reported the $73,399.25 in attorney's fees as a miscellaneous itemized deduction. In 1995, petitioner filed an Amended U.S. Individual Income Tax Return, Form 1040X, for the 1993 taxable year, excluding the $150,000 judgment from income, thereby eliminating the need to claim the $73,399.25 in attorney's fees. As a result, petitioner reported that her corrected tax liability was $437, that she had paid $20,512, and that she was entitled to a refund of $20,075.

OPINION

Respondent determined that petitioner's 1993 gross income included the $150,000 award. Respondent also determined that

petitioner's legal fees and costs totaling $73,399.25 were deductible as a miscellaneous itemized deduction, subject to the 2-percent floor under section 67. Respondent did not allow the miscellaneous itemized deduction for legal fees in computing petitioner's alternative minimum taxable income. Thus, under respondent's determination, petitioner would be subject to alternative minimum tax (AMT), under sections 55 and 56, of $17,402. Petitioner contends that the $150,000 award is excludable from income, or alternatively, if the award is not excludable, the portion of the award paid as attorney's fees is excludable from income, and petitioner is not liable for AMT.

Excludability of Title VII Judgment Proceeds

We must first decide whether petitioner's title VII judgment proceeds are excludable from gross income. Except as otherwise provided, gross income includes income from all sources. See sec. 61(a); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). Although section 61(a), concerning the inclusion of income, has been broadly construed, statutory exclusions from income have been more narrowly construed. See *Commissioner v. Schleier*, 515 U.S. 323, 327-328 (1995); *Kovacs v. Commissioner*, 100 T.C. 124, 128 (1993), affd. without published opinion 25 F.3d 1048 (6th Cir. 1994).

One such statutory exclusion appears in section 104(a)(2). Under section 104(a)(2), gross income does not include "the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness". The regulations provide that

> The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, through a settlement agreement entered into in lieu of such prosecution.

Sec. 1.104-1(c), Income Tax Regs. Thus, damages may be excluded from gross income only if petitioner shows that (1) the underlying cause of action giving rise to the recovery is based upon tort or tort type rights, and (2) the damages were received on account of personal injuries or sickness. See *Commissioner v. Schleier*, *supra* at 336-337; *Wesson v. United States*, 48 F.3d 894, 901-902 (5th Cir. 1995); *Bagley v. Commissioner*, 105 T.C. 396, 416 (1995), affd. 121 F.3d 393 (8th Cir. 1997).

When damages are received pursuant to a suit or settlement agreement, the nature of the underlying claim determines whether such damages are excludable under section 104(a)(2). See *United States v. Burke*, 504 U.S. 229 (1992); *Thompson v. Commissioner*, 866 F.2d 709, 711 (4th Cir. 1989), affg. 89 T.C. 632 (1987); *Robinson v. Commissioner*, 102 T.C. 116, 126 (1994), affd. in part, revd. in part, and remanded on another ground 70 F.3d 34 (5th Cir. 1995). Determining the nature of the claim is a factual inquiry. See *Bagley v. Commissioner*, *supra* at 406; *Stocks v. Commissioner*, 98 T.C. 1, 11 (1992). The claim must be bona fide, but not necessarily valid. See *Taggi v. United States*, 35 F.3d 93, 96 (2d Cir. 1994); *Robinson v. Commissioner*, *supra* at 126; *Stocks v. Commissioner*, *supra* at 10. The crucial question is "in lieu of what was the settlement amount paid?" *Bagley v. Commissioner*, *supra* at 406.

In *United States v. Burke*, *supra*, the taxpayers brought a sex discrimination claim under title VII against their employer. The parties subsequently settled the case, and the employer withheld Federal income taxes on the settlement received by the taxpayers. The taxpayers sought refunds of the withheld taxes on the ground that the settlement was excludable under section 104(a)(2) as "'damages received * * * on account of personal injuries or sickness.'" *Id.* at 232 (quoting section 104(a)(2)).

The Supreme Court held that the nature of the claim underlying the taxpayers' settlement determined the

excludability of the settlement under section 104(a)(2). See *id.* at 237. The Court noted that title VII focused on "'legal injuries of an economic character'" and limited the available remedy to backpay awards and injunctive relief. *Id.* at 238-239 (quoting *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 418 (1975)). The Court further stated:

> Nothing in this remedial scheme purports to recompense a Title VII plaintiff for any of the other traditional harms associated with personal injury, such as pain and suffering, emotional distress, harm to reputation, or other consequential damages * * *.

Id. at 239. Because the taxpayers' remedies under title VII were limited to wages on which they otherwise would have been taxed, the Court held that title VII's sole remedial focus was the award of back wages and did not redress a tortlike personal injury within the meaning of section 104(a)(2) and the applicable regulations. See *id.* at 241. As such, the settlements received by the taxpayers pursuant to their title VII claims were not excludable from gross income under section 104(a)(2).

Similar to the taxpayers in *United States v. Burke*, *supra*, petitioner brought a claim under title VII against her employer. Since the damages available to petitioner as a title VII claimant consisted only of wages,[3] which would otherwise be taxable, the $150,000 recovery received by petitioner as partial payment

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[3] In 1991, the Civil Rights Act, Pub. L. 102-166, 105 Stat. 1071 (1991), expanded the damages available under title VII and created a right of recovery for compensatory and punitive damages for certain intentional violations of title VII. In *Landgraf v. USI Film Prods.*, 511 U.S. 244 (1994), the Supreme Court held that the 1991 amendments to the Civil Rights Act did not apply retroactively. Because petitioner's title VII suit was filed in 1990 and the conduct underlying the suit occurred from 1981 to 1984, the application of sec. 104(a)(2) to any amounts received from petitioner's title VII claim must be considered in light of the Civil Rights Act as it existed prior to the 1991 amendments. See *Clark v. Commissioner*, T.C. Memo. 1997-156. In any event, there is no evidence that petitioner sought in her Complaint or was awarded damages on account of personal injury.

of her title VII judgment does not constitute "damages received * * * on account of personal injuries". Thus, under the reasoning of *Burke*, petitioner's title VII recovery is not excludable from gross income under section 104(a)(2).

Petitioner advances several arguments in support of her contention that the proceeds received from her title VII claim are excludable from income. Petitioner's first argument draws upon the reasoning contained in a dissenting view expressed by Justice O'Connor in *United State v. Burke*, *supra* at 249. That dissenting view suggests that the focus should be on the broad policy underlying title VII rather than the possible remedies available to claimants. In the dissent, it was also pointed out that title VII actions did not "fix the character of the right" that plaintiffs were seeking to enforce. Trying to capitalize on that reasoning, petitioner contends that, under the laws of her State, her suit was based in common-law torts (assault, battery, sexual assault, and sexual battery). Although the form of the title VII relief was denominated as "wages", petitioner argues that, in substance, her claim was founded in tort. We note, however, that if petitioner had an alternative cause of action under State law, she chose not to pursue it and, instead, brought her action under title VII.

In order to bolster her substance argument, petitioner cites *Central Foundry Co. v. Commissioner*, 49 T.C. 234, 251 (1967), and states that the tax treatment of the result of litigation should not turn upon which remedy or course of action is selected by the taxpayer. *Central Foundry Co.* addressed whether a corporation could deduct the reimbursement of shareholders' expenses from a successful proxy fight as ordinary and necessary business expenses. The Court stated that no matter which remedy the shareholder selected, a derivative action or a proxy contest, it was the proximate relationship to the corporation and the benefit to the corporation that determined whether the expenses were deductible. *Central Foundry Co.*, however, has not been relied upon by this Court, or any other court, for guidance in

determining whether recoveries by taxpayers are excludable from gross income under section 104(a)(2). Thus, we do not view *Central Foundry Co.* as persuasive support for petitioner's position that the focus should be on the legislative policy underlying title VII rather than the possible remedies available to claimants.

More important, however, is the fact that the Supreme Court did not follow the dissent's view in *Burke* and held that a claim under title VII is not based on a "tort or tort type" right, taking account of the kinds of remedies that may be awarded for that claim. *United States v. Burke*, *supra* at 234-237. Because pre-1991 title VII remedies were limited to backpay and injunctive relief, the Court held that a sex discrimination claim did not assert a "tort or tort type" right. Regardless of whether petitioner's claims may have had an analogue at common law, the Supreme Court in *Burke* looked to the remedy that was addressed by title VII.

Petitioner also argues that *Burke* should be read narrowly to apply to cases based on economic acts that result predominately in economic harm. Petitioner contends that in cases where common law tort remedies exist, *Burke* should not apply. Petitioner, in an attempt to distinguish *Burke*, points out that the taxpayers' sole claim in that case was for damages based on economic rights, whereas petitioner had a tort claim at common law. We disagree with petitioner since the majority opinion in *Burke* did not address possibilities outside of title VII.

More importantly, petitioner's recovery here was based entirely on title VII, and no evidence was presented establishing that petitioner had any other remedies at common law. Even assuming petitioner did have other avenues of relief outside title VII, petitioner chose to file a title VII action and is now bound by the tax consequences that attach to recoveries under title VII. We hold that the proceeds from petitioner's title VII award are not excluded from gross income under section 104(a)(2).

Excludability of Attorney's Fees

The next issue for our consideration is whether petitioner is entitled to exclude from her gross income that portion of her title VII proceeds paid as attorney's fees. Petitioner argues that if section 104(a)(2) does not apply and her title VII judgment proceeds are includable in her 1993 gross income, the $73,399.25 paid to her attorneys is excludable from her gross income because it was paid directly to her counsel under a contingent fee retainer agreement. We note at the outset that this Court has, relying on the well-established assignment of income doctrine, uniformly rejected the contention that taxpayers may exclude the amount of their legal fees and costs from gross income. See *Kenseth v. Commissioner*, 114 T.C. ____ (2000); *O'Brien v. Commissioner*, 38 T.C. 707, 712 (1962), affd. per curiam 319 F.2d 532 (3d Cir. 1963); *Benci-Woodward v. Commissioner*, T.C. Memo. 1998-395.

Petitioner relies on *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959), affg. in part and revg. in part 28 T.C. 947 (1957), arguing that, under the "attorney's lien" rationale, an attorney's contingent fee portion of a judgment is not included in the taxpayer's income. In *Cotnam*, the taxpayer and her attorneys entered into a contingent fee agreement under which the attorneys would receive 40 percent of any amount recovered on behalf of the taxpayer on her claim. The taxpayer received a judgment on the claim, and a check in the amount of the judgment was made payable to both her and her attorneys. The attorneys retained their share of the proceeds and remitted the rest to the taxpayer. In holding that the amount retained by the attorneys was not includable in the taxpayer's gross income, the Court of Appeals for the Fifth Circuit concluded that under Alabama State law (the applicable law in *Cotnam*) the contingent fee arrangement operated to assign to the attorneys an equitable lien and interest as to 40 percent of the judgment. As stated in the provision of the Alabama Code relied upon by the Court of Appeals:

> 2. Upon suits, judgments, and decrees for money, * * * [attorneys] shall have a lien superior to all liens but tax liens, and no person shall be at liberty to satisfy said suit, judgment or decree, until the lien or claim of the attorney for his fees is fully satisfied; and attorneys at law shall have the same right and power over said suits, judgments and decrees, to enforce their liens, as their clients had or may have for the amount due thereon to them.

Cotnam v. Commissioner, *supra*, at 125 n.5 (quoting 46 Ala. Code sec. 64 (1940)).

The parties here agree that Missouri law is the applicable law in this case. Petitioner argues that the Missouri statute regarding attorney liens is similar to that of the Alabama statute quoted above, and therefore *Cotnam* is applicable here. We disagree. In the present case, the applicable Missouri statute provides as follows:

> The compensation of an attorney or counselor for his services is governed by agreement, express or implied, which is not restrained by law. From the commencement of an action or the service of an answer containing a counterclaim, the attorney who appears for a party has a lien upon his client's cause of action or counterclaim, which attaches to a verdict, report, decision or judgment in his client's favor, and the proceeds thereof in whosesoever hands they may come; and cannot be affected by any settlement between the parties before or after judgment.

Mo. Ann. Stat. sec. 484.130 (West 1987). This provision stands in marked contrast to the provision of the Alabama Code relied on in *Cotnam*. Although both provisions give an attorney a lien to secure his or her compensation, the Missouri provision, unlike the Alabama provision, does not give attorneys the same right and power over suits, judgments, and decrees as their clients had or may have.

While we agree with petitioner that Missouri law does provide attorneys with a lien interest in their client's cause of action, we are unable to find, and petitioner fails to cite, any authority under Missouri law that transfers to the attorneys an ownership or proprietary interest in their client's cause of action. Rather, the cases that petitioner has cited only allow attorneys a lien interest, as opposed to an equity or ownership interest, in their client's cause of action. In Missouri, attorneys do not have the same substantive rights in proceeds recovered on behalf of their clients as do attorneys in Alabama. See *Mills v. Metropolitan St. Ry. Co.*, 221 S.W. 1, 4 (Mo. 1920) ("the cause of action is the property of the client and not the attorney").

The Missouri provision granting a lien interest to secure an attorney's compensation is more akin to those attorney lien provisions of States that have been distinguished from the attorney lien provisions of Alabama. See *Baylin v. Commissioner*, 43 F.3d 1451, 1455 (Fed. Cir. 1995) (holding Maryland attorney lien statute does not give attorney an ownership interest in claim of his or her client); *Estate of Gadlow v. Commissioner*, 50 T.C. 975, 979-980 (1968) (Pennsylvania law distinguishable from Alabama statute); *Petersen v. Commissioner*, 38 T.C. 137, 151-152 (1962) (holding Nebraska attorney lien statute distinguishable from Alabama attorney lien statute); *Coady v. Commissioner*, T.C. Memo. 1998-291 (Alaska attorney lien statute distinguishable from Alabama statute).

Petitioner next contends that Missouri law provides the same attorney lien priority as does Alabama law. In *Cotnam*, the court interpreted Alabama law as providing an attorney lien with a superior priority over the defendant's set-off right against the plaintiff. See *Cotnam v. Commissioner*, *supra* at 125. Petitioner relies on *Hillside Enters., Inc. v. Carlisle Corp.*, 944 F. Supp. 793, 802 (E.D. Mo. 1996), for the proposition that Missouri case law has recognized the same superior attorney lien priority concept as stated in *Cotnam*. The District Court's

decision in *Hillside*, however, was reversed by the Court of Appeals for the Eighth Circuit in *Hillside Enters. Inc. v. Continental Carlisle, Inc.*, 147 F.3d 732 (8th Cir. 1998). In reversing, the Court of Appeals concluded that the lower court's holding regarding the attorney lien priority was contrary to Missouri law and that, under Missouri law, an attorney's lien on the plaintiff's judgment is inferior to the defendant's right to set off its own judgment against the plaintiff. *Hillside Enters., Inc. v. Continental Carlisle, Inc.*, 147 F.3d at 735. The fact that Missouri law subordinates an attorney's lien to the rights existing between the parties to the action or proceeding clearly distinguishes it from the Alabama provision cited in *Cotnam* where the lien of an attorney is "superior to all liens but tax liens." 46 Ala. Code sec. 64 (1940). Based on the foregoing, we find petitioner's case distinguishable from *Cotnam* and hold that petitioner's gross income includes the $73,399.25 of her title VII proceeds paid to her counsel as attorney's fees.[4]

Petitioner complains that she is not subject to AMT because the attorney's fees portion of the judgment is not included in gross income. We have held that petitioner's gross income includes the portion of her title VII proceeds paid to her counsel as attorney's fees, and therefore petitioner's argument that she is not subject to AMT is rejected.

Petitioner concedes that if the entire $150,000 award is included in her gross income, the proper treatment of the attorney's fees is as a miscellaneous itemized deduction as reported on petitioner's 1993 original return. Section 162 (a) provides that there "shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business". Legal fees incurred by a taxpayer as an expense of employment are

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[4] We would reach this same holding irrespective of the differences between the Missouri and Alabama attorney lien statutes. See *Kenseth v. Commissioner*, 114 T.C. ___ (2000) (majority rejected the reasoning of *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959), affg. in part and revg. in part 28 T.C. 947 (1957)).

miscellaneous itemized deductions, subject to the overall limitation on itemized deductions. See secs. 67 and 68; *Alexander v. Commissioner*, 72 F.3d 938 (1st Cir. 1995); affg. T.C. Memo. 1995-51; *Bagley v. Commissioner*, 105 T.C. at 419. Accordingly, petitioner's legal fees are deductible as a miscellaneous itemized deduction.

Petitioner does not dispute respondent's contention that the treatment of the attorney's fees as a miscellaneous itemized deduction triggers the application of the AMT under sections 55 and 56. Under section 56(b)(1)(A)(i), an individual taxpayer's deduction for miscellaneous itemized deductions is not allowed in computing alternative minimum taxable income. See *Alexander v. Commissioner*, *supra* at 946-947. Therefore, petitioner is not permitted to deduct her attorney's fees as a miscellaneous itemized deduction for purposes of computing AMT.

To reflect the foregoing,

Decision will be entered for respondent.